Appendix A

Not to be Published in Official Reports

In the Court of Appeal
of the State of California
In and for the Third Appellate District
(Shasta)
3 Civil 17097
(Super. Ct. No. 49628)

Great American Insurance Company, a corporation,
Plaintiff and Respondent,

vs.

Frank R. Sargent,
Defendant and Appellant.

[Filed July 27, 1979]

OPINION

Appellant Frank R. Sargent appeals from a judgment of the Shasta County Superior Court and from an order denying his request for a new trial. Appellant contends that the trial court erred in litigating issues not submitted in violation of a stipulation of the parties, that the litigation of the issues violated his right to a jury trial, that respondent waived contract defenses by filing an action in interpleader, that his counsel was so negligent as to have prevented a trial on the merits, and that the judgment is incorrect. Appellant filed his brief in propria persona wherein he inartfully explains his reasons for objecting to the judgment; however, his brief does disclose his major contention—that the trial court erred in litigating the issue of defenses on a contract of insurance in the context of an

interpleader action. On the facts of this case we agree and reverse the judgment, and remand with directions.

I

In 1972 respondent issued its standard California fire insurance policy covering the building, equipment, stock and inventory of the Casa Blanca motel and restaurant in Redding, California, to appellant and his wife. The Casa Blanca was owned and operated by appellant. The insurance policy contained a standard mortgage endorsement which insured as mortgagees (in order of preference): (1) Gibraltar Savings and Loan Association—$18,386.59; (2) the Corradetti group—$129,906.26; and (3) C. S. and Bhulabhai G. Patel—$87,183.48. In the early morning hours of January 6, 1973, a fire destroyed the restaurant and bar of the Casa Blanca.

Appellant and respondent were unable to agree as to the actual cash value of the property destroyed or the amount of loss. The matter was submitted for an appraisal under the terms of the policy and the appraisal award was subsequently affirmed in court. The amount of the loss was found to be $108,520.00. Counsel stipulated that under the terms of the policy there was payable $71,669.00. Of that sum, respondent had paid $6,484.00 for removal of debris. Respondent then paid Gibraltar $18,386.59 on its note and first trust deed, and in return took an assignment of the note and trust deed. The insurance policy contained a clause providing that in the event the company claims to have defenses on the contract against the owner, it may accept an assignment of the note and trust deed when making payment to the creditor. Appellant then filed suit against respondent on January 4, 1974, in the San Fran-

cisco Superior Court seeking compensatory and punitive damages based upon the policy.

The payment of the amounts for debris removal and on Gibraltar's deed of trust left remaining $46,798.41 of the amount due under the policy. Respondent then filed a complaint in interpleader on July 1, 1974, asserting that it could not safely determine for itself where the remaining proceeds under the policy should be paid and asserting that it claimed no interest in them. Appellant demurred to the complaint in interpleader and the demurrer was overruled by the trial court. Various named defendants, including appellant, then answered the complaint asserting interests in the interpleaded fund. Defendants Corradetti later amended their answer to allege that the sum did not represent the entire balance of the insurance proceeds in that respondent had not satisfied the first deed of trust but had rather purchased the note and deed of trust.

A pretrial conference was held on August 8, 1975. At the conference the question of the Gibraltar note and deed of trust was brought up. Counsel for the junior lien holders wished to reserve their right to challenge the assignment of the Gibraltar deed of trust as taking priority over them. The court was unwilling to proceed on that basis, and suggested that the deed of trust be deposited with the clerk pending its determination of the respondent's right to its assignment. Respondent declined to do this, and the court then ordered that unless respondent agreed to submit that issue to the court the interpleader action would not proceed further. Respondent then consented to the court's suggestion. Throughout the conference the trial court insisted that it would not proceed with the interpleader action without also considering the assignment of the Gibraltar deed of trust to respondent.

In the pretrial conference, concern was expressed by the parties over the effect of the litigation upon other actions. The court insisted that the issue of the Gibraltar deed of trust be litigated, but stated that it did not want to have the determination reached be a bar to issues not actually litigated. The court told appellant's counsel that the issues in the San Francisco action would not be adjudicated in this proceeding unless the pleadings were amended. Throughout the conference respondent maintained that it was entitled to an assignment of the Gibraltar deed of trust, but that it did not care to whom the remainder of the fund went.

Respondent and several of the defendants moved for summary judgments. In its decision on the motions for summary judgment the trial court noted that the Corradetti defendants had foreclosed under their deed of trust and had thereby purchased the property. The court then discussed the motions for summary judgment. It held that respondent was entitled to interplead the amounts previously paid into court ($46,798.41). The court denied respondent's motion for summary judgment as to the effectiveness of the assignment of the Gibraltar deed of trust, and held that that matter must be tried. In so doing, however, the court held that if the assignment was found good against appellant it would be good against the junior lien holders as well. The court stated that the Corradettis would have been entitled to the fund had they not foreclosed their trust deed, but since they had done so they must litigate their entitlement to a deficiency judgment. The court finally ruled that the Patels must litigate their claim, recovering only that to which the Corradettis fail to establish an entitlement.

On May 7, 1976, a supplemental pretrial conference was held. Appellant did not appear. The court ruled that prior to trial of the interpleader action, the nature and extent of any breach of the insurance contract would be tried in order to determine the rights of respondent to take an assignment of the Gibraltar trust deed and note.

On August 11, 1976, appellant filed a "memorandum of points and authorities by defendant Frank R. Sargent re: scope of trial." He reiterated his position that the issues before the San Francisco Superior Court, i.e., defenses of respondent against appellant on the insurance contract, should not be litigated in the Shasta County proceeding. Counsel informed the court of his understanding that the San Francisco issues would not be tried or jeopardized, and sought to have the trial date vacated. The trial court rejected the request and proceeded with the trial.

On December 15, 1976, the court issued its announcement of intended decision. It found that appellant operated the restaurant willfully and knowingly in a manner which increased hazards, that he committed fraud in his proof of loss submitted to respondent, that he failed to safeguard the insured property after the fire, and that he failed to submit to an examination under oath pursuant to provisions of the policy. The court concluded that appellant was in material breach of the policy provisions and that due to such breach he forfeited his rights under the policy to indemnification. Judgment was entered on February 17, 1977. The trial court thereafter denied appellant's motion for a new trial.

II

In order to understand the nature of the proceedings it is necessary to review the contractual and legal basis for respondent's contention that it was entitled to an assignment of the Gibraltar note and trust deed. The ordinary rule is that breach of the contract of insurance by the mortgagor will defeat recovery by the mortgagee. (Ins. Code, § 171; Holbrook v. Baloise Fire Ins. Co. (1897) 117 Cal. 561, 566.) The policy involved in this case specifically provided that the interest of the mortgagees would not be defeated by any act of neglect of the owner or by the use of the property in a manner more hazardous than permitted by the policy. The interest of a mortgagee in the property is a separate insurable interest; the effect of such a clause is that the mortgagee has a separate contract of insurance on his interest. (See Mosee v. Firemen's Ins. Co. of Newark (1927) 87 Cal.App. 473, 475-476.) Thus, although the insurer may have defenses against the owner of the property, it must still stand responsible to the mortgage holder in the event of loss.

In the event of loss, if the insurer should make payments to the mortgage holder and the mortgage be discharged, the owner would be benefited in that his property would no longer be subject to the mortgage. Where the insurer has defenses against the owner of the property, the owner would thereby be unjustly enriched by having the mortgage discharged. In order to prevent this result the Insurance Code provides that an insurance policy may contain a clause providing that the insurer may pay the mortgagee and be subrogated to all his rights of recovery, or it may require an assignment of the mortgage in the event the insurer claims defenses against the owner. (Ins. Code, § 2071.) The contract in question contained such a clause.

When the Casa Blanca was damaged by fire and the amount of the loss and amount payable under the policy had been determined, the company believed it had defenses against Sargent, but such defenses would not be available against the mortgage holders. The amount payable under the policy was more than sufficient to pay off the note and first trust deed held by Gibraltar, and the insurer therefore paid Gibraltar and took an assignment of the note and trust deed. The amount remaining under the policy was of course insufficient to pay the remaining indebtedness secured by the property and insured under the policy, and the company sought to interplead that amount and allow distribution of it to be determined by the court. Respondent repeatedly asserted to the trial court that it was not concerned over which claimant received the remaining funds.[1]

No party to the action disputed respondent's right to make payments on the Gibraltar note and deed of trust. It is clear from the terms of the policy that respondent had the right and duty to make that payment. The Corradettis, however, raised a question concerning the propriety of the assignment of the note and deed of trust when they learned of it. They first amended their answer to state that the fund deposited with the court was not the entire fund and the action should therefore be considered a partial interpleader, and to seek to have respondent discharged only as

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[1]Code of Civil Procedure section 386 provides for an action in interpleader. At the time respondent filed its complaint it was required to admit that it had no interest in the fund, or at least in a portion of the fund. (Code Civ. Proc., § 386. See also 3 Witkin, Cal. Procedure, pp. 1891-1900.) In 1975, Code of Civil Procedure section 386 was amended to provide that the claims against the party seeking to interplead need not be liquidated and present liability is not required. (Code Civ. Proc., § 386, subd. (b); 3 Witkin, Cal. Procedure (1979 Supp.), § 217, subd. (a).)

to the amount deposited in court and not as to the Gibraltar note and deed of trust. At the pretrial conference the matter was discussed. The Corradettis asserted that the effect of the assignment was as though respondent had purchased the note and deed of trust with its own funds, and that if that was the case then the $18,386.59 paid to Gibraltar could not properly be a credit on the amount of the policy proceeds available to other claimants. Counsel for respondent pointed out to the court that respondent was not claiming an interest in the remaining proceeds of the policy as the holder of a note and first trust deed.

The assignment of the Gibraltar note and first deed of trust to respondent had no effect on the amount of the policy proceeds which respondent sought to interplead. Issues would remain over whether appellant's property was still subject to the deed of trust and if so, whether the deed of trust had priority over the other creditors. Those issues did not affect in any way the fund deposited in court by respondent or the disposition to be made of those funds. The court, however, refused to proceed with the interpleader action unless it was also allowed to consider those issues in a declaratory action. When respondent agreed to submit the issue of the validity of the assignment of the deed of trust new pleadings were not required by the court. The court thus took upon itself to litigate a matter not raised and not affecting the original proceeding without any pleading on the matter and in opposition to the parties' desires.

Code of Civil Procedure section 576 provides that any judge, at any time before or after commencement of trial, in furtherance of justice and upon such terms as may be proper, may allow the amendment of any pleading or pre-

trial order. The allowance of amendments rests in the discretion of the trial court and its determination will not be disturbed unless it clearly appears that such discretion has been abused. (Trafton v. Youngblood (1968) 69 Cal.2d 17, 31.) An abuse of discretion is not shown unless by permitting the amendment new and substantially different issues are introduced into the case or the rights of the adverse party are affected. (*Ibid.*) We note that the trial court herein did not allow amendment to the pleadings or pretrial order *upon request of the parties,* but itself compelled the parties to agree to litigate a distinct action involving distinct issues, as a condition of proceeding on the interpleader action. The court abused its discretion in doing so. Its only proper course was to allocate the interpleaded funds among the claimants to it, after deducting costs and attorney fees for respondent.

The source of the trial court's error is apparent from the judge's comments. Somehow the judge conceived the idea that if the assignment were found invalid under the insurance contract, i.e., if the insurer's claimed defenses on the policy were disallowed, this would generate an additional sum of money ($18,386.59) to be allocated among the interpleaded junior lienholders; none of the attorneys disagreed, at least not persuasively. The fallacy of the trial court's reasoning lies in its misconception of the nature and purpose of the assignment and of Insurance Code section 2071. The existence of defenses on the policy, if established, would normally vitiate the policy and annul the insurer's obligation to pay at all. But as to a third party mortgagee, such defenses are inapplicable, so the third party is paid in spite of them, thus eliminating the risk of foreclosure due to default. But the defenses are no less

valid in such event as against the insured, who is thereby enriched by payoff of his obligation to the mortgagee; to prevent this, section 2071 provides for assignment rather than payoff, thus preserving to the insurer its defenses. If they are ultimately sustained, the insurer may foreclose on the deed of trust or mortgage and thus recoup the money it improperly paid thereon; such money becomes and remains that of the insurer and no one else. If on the other hand the defenses asserted by the insurer are not sustained, the insurer releases the security and does not recoup from its insured and the money earlier paid to the mortgagee stays with the mortgagee. Either way the assignment clause in the policy cannot generate additional funds for junior lienholders, or for the insured; it can only generate reimbursement to the insurer of funds it should not have paid. It is a practical device by which a third party mortgagee is paid promptly, leaving an insurer who asserts policy defenses to litigate them without the threat of foreclosure.

The original complaint was filed in interpleader. The validity of the assignment of the note and the deed of trust from Gibraltar to respondent in no way affected the fund that had been interpled or the parties' right thereto. There is no provision in an interpleader proceeding for the expansion of the proceeding into a general declaratory relief proceeding. (See Code of Civ. Proc., §§ 386-386.6; 3 Witkin, Cal. Procedure (2d ed. 1971) Pleading, §§ 216-232, pp. 1891-1907.) The declaratory relief action in this case proceeded at the trial judge's insistence at the pretrial conference, and in the absence of pleadings and pretrial procedure. The matter litigated was an entirely new matter to the complaint in interpleader and as such should have been

subjected to the normal course of pleading. The manifest result of the attempt to proceed in declaratory relief without proper pleadings and pretrial proceedings was extensive confusion among counsel throughout the proceedings concerning the nature of the proceeding and whether their clients would be affected by any ruling. In fact, when the court convened to hear the issue counsel for the other defendants in the interpleader action informed the court that they were not concerned with that issue and absented themselves. There remained only appellant, who had earlier informed the court that he did not contend that the assignment of the deed of trust was invalid. There was thus no one before the court contesting the issue which the court intended to litigate, yet the court went forward and tried the issue. It is settled that courts should not render purely advisory opinions, and in the context of the interpleader action the findings of the court relative to appellant's breach of the insurance contract were not at issue. (Younger v. Superior Court (1978) 21 Cal.3d 102, 119-120.) The court thus abused its discretion in trying the issue.

Despite the foregoing, the Corradettis and the Patels did not appeal and appellant's appeal does not contest the court's judgment and findings relative to the interpleader action. Appellant's sole complaint is that the findings of the trial court might be asserted as res judicata or collateral estoppel in his San Francisco action. The judgment herein does not make reference to a breach of the insurance contract by appellant; however, the findings of fact and conclusions of law do state that he did so. We deem those findings irrelevant to the interpleader action. The error may

be corrected by striking from the findings and conclusions any reference to the alleged breach of contract.[2]

The judgment is remanded with directions to enter new findings of fact and conclusions of law and a judgment in conformity with the views expressed herein. Otherwise it is affirmed. Appellant shall recover costs on appeal.

/s/ Reynoso, J.

We concur:

Paras, Acting P.J.

Evans, J.

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[2]Appellant requests findings of fact on appeal. California Rules of Court, rule 23 (a) provides for the request of a party for findings of fact on appeal. In view of the result reached it is unnecessary to consider appellant's remaining contentions; thus, findings of fact on those contentions are not necessary.